

**Before the  
Federal Communications Commission  
Washington, D.C. 20554**

In the Matter of	)	
	)	
Multi-Association Group (MAG) Plan for	)	CC Docket No. 00-256
Regulation of Interstate Services of Non-Price	)	
Cap Incumbent Local Exchange Carriers and	)	
Interexchange Carriers	)	
	)	
Federal-State Joint Board on Universal	)	CC Docket No. 96-45
Service	)	
	)	
Access Charge Reform for Incumbent Local	)	CC Docket No. 98-77
Exchange Carriers Subject to Rate-of-Return	)	
Regulation	)	
	)	
Prescribing the Authorized Rate of Return for	)	CC Docket No. 98-166
Interstate Services of Local Exchange Carriers	)	

**RURAL CONSUMER CHOICE COALITION  
REPLY TO OPPOSITIONS TO  
ITS PETITION FOR RECONSIDERATION**

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February 25, 2002

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## I. INTRODUCTION & SUMMARY

The Rural Consumer Choice Coalition (“RCC Coalition”), and its members, AT&T, General Communication Inc. and Western Wireless, respectfully submit this reply in connection with their petition for reconsideration of the Commission’s *MAG Order*<sup>1</sup> filed on December 28, 2001.<sup>2</sup>

The ILEC Oppositions do not contest this core fact: toll rate averaging and rate integration as they exist today provide implicit support for access to interexchange service, a service that the FCC, after recommendation from the Federal-State Joint Board, designated as supported by federal universal service mechanisms. However, the United States Court of Appeals for the Fifth Circuit has made crystal clear – in three decisions binding upon the Commission – that subsidies for services designated under Section 254(a) and (c) to be “supported by Federal universal service support mechanisms”<sup>3</sup> “must be explicit.”<sup>4</sup> The Fifth Circuit commanded that “the ‘FCC cannot maintain any implicit subsidies’ whether on a

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<sup>1</sup> *Multi-Association Group (MAG) Plan for Regulation of Interstate Services of Non-Price Cap Incumbent Local Exchange Carriers and Interexchange Carriers; Federal-State Joint Board on Universal Service; Access Charge Reform for Incumbent Local Exchange Carriers Subject to Rate-of-Return Regulation; Prescribing the Authorized Rate of Return for Interstate Services of Local Exchange Carriers*, Second Report and Order and Further Notice of Proposed Rulemaking in CC Docket No. 96-45, and Report and Order in CC Docket Nos. 98-77 and 98-166, FCC 01-304 (“*MAG Order*” or “*Order*”).

<sup>2</sup> This reply responds to oppositions filed on February 14, 2002 by National Telephone Cooperative Association (“NTCA”), National Rural Telecom Association, the Organization for the Promotion and Advancement of Small Telecommunications Companies, and the United States Telecom Association (“NRTA et al.”), South Dakota Telecommunications Association (“SDTA”), Plains Independent Rural Companies (“Plains”), and Innovative Telephone (“Innovative”) (collectively the “ILECs”), and to comments filed by the States of Alaska and Hawaii (the “State Comments”).

<sup>3</sup> 47 U.S.C. §§ 254(a)(2), (c)(1).

<sup>4</sup> *COMSAT v. FCC*, 250 F.3d 931, 939 (5<sup>th</sup> Cir. 2001) (citing *Texas Office of Public Utility Counsel v. FCC*, 183 F.3d 393, 425 (5<sup>th</sup> Cir. 1999) (“*TOPUC I*”), and *Alenco v. FCC*, 201 F.3d 608, 623 (5<sup>th</sup> Cir. 2000)).

permissive or mandatory basis,”<sup>5</sup> yet that is precisely what the Commission did when it continued to subsidize rural ILECs’ high access costs implicitly through toll averaging requirements instead of creating an explicit support mechanism for these interstate costs. The provisions of the *MAG Order* failing to establish explicit support for traffic sensitive costs are therefore plainly contrary to law, and must be reconsidered.

Significantly, in connection with the RCC Coalition’s request that the Commission reconsider its treatment of TIC costs in the *MAG Order*, one of the Coalition’s most vocal critics (Plains) actually agrees that “there is no is no evidence to support assignment of TIC cost recovery to local switching.”<sup>6</sup> The ILECs (including Plains), however, continue to fail to recognize that the TIC only contains residual costs not associated with specific service elements, and that in deciding how to recover these costs, the Commission has erred on the side of non-traffic sensitive recovery.

Finally, no party even attempts to defend the Commission’s reasoning on the issues of the information surcharge and marketing costs, or to explain how the *MAG Order*’s treatment of those costs can be squared with Commission precedent. NTCA’s arguments are, moreover, as clearly erroneous as those set forth in the *MAG Order*.

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<sup>5</sup> *COMSAT*, 250 F.3d at 939.

<sup>6</sup> Plains Opposition at 8.

**II. THE OPPOSITIONS DO NOT DISPUTE THAT SECTION 254(e) REQUIRES THAT SUPPORT FOR TRAFFIC SENSITIVE ACCESS COSTS BE MADE EXPLICIT.**

**A. The ILEC Oppositions Do Not Dispute The RCC Coalition's Economic Showing That Toll Rate Averaging And Integration Implicitly Subsidize High Rural ILEC Access Costs.**

No one disputes that rural rate-of-return ILECs have high access costs. Indeed, the ILECs reiterate this.<sup>7</sup> No party – neither the ILECs nor the state commenters – disputes that a fundamental result of geographic rate averaging and rate integration is to provide an implicit subsidy for high rural rate-of-return ILEC switched access costs.

As the Fifth Circuit has explained, “[i]mplicit subsidies . . . involve the manipulation of rates for some customers to subsidize more affordable rates for others. For example, the regulators may require the carrier to charge ‘above-cost’ rates to low-cost, profitable urban customers to offer the ‘below-cost’ rates to expensive, unprofitable rural customers.”<sup>8</sup> That is exactly what the toll averaging and rate integration requirements, combined with high access charges in rural areas, do: they require the IXC to charge a higher rate (higher than necessary to recover the relatively low access costs incurred when serving that customer) to urban customers in order to offer a lower, nationwide averaged rate (a rate that does not reflect the high access costs incurred when serving the rural rate-of-return ILEC customer) to rural customers. Furthermore, “the implicit/explicit distinction turns on the distinction between direct subsidies from support funds and recovery through access charges and rate structures.”<sup>9</sup> There is no possible claim that the support provided for high rural rate-of-return ILEC costs is a direct

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<sup>7</sup> See, e.g., NTCA Opposition at 3; Innovative Opposition at 8.

<sup>8</sup> *TOPUC I*, 183 F.3d at 406.

<sup>9</sup> *Alenco*, 201 F.3d at 623.

subsidy from support funds: it can only be recovery through access charges and rate structures, and thus is implicit.

If there were any doubt that rate averaging and rate integration create an implicit subsidy for high rural rate-of-return ILEC access costs, that doubt is erased simply by looking at the underlying access costs per conversation minute. As Exhibit C(2) to the RCC Petition showed, an IXC originating traffic only in price cap LEC service areas even after the *MAG Order* pays substantially less in access charges (over 1.7 cents per conversation minute) than a carrier originating traffic only in a NECA carrier area. Section 254(g), however, bars a single IXC serving both those areas from charging 1.7 cents per minute more to the customer in the NECA area, and instead requires that IXC to shift the recovery of the NECA carrier's high access costs to all other long distance customers. This mandatory shifting of recovery of high access costs is an implicit subsidy as defined by the Fifth Circuit's decisions.

**B. No Party Disputes That Access To Interexchange Service Is A Supported Service.**

No party filing oppositions or comments contests that access to interexchange service is a service supported by federal universal service support mechanisms, or that switching and transport are necessary components of obtaining access to interexchange services. The Commission's Rule 54.101(7) expressly states that "access to interexchange services" is among the "services or functionalities [that] shall be supported by Federal universal support mechanisms." A customer does not gain access to interexchange services simply by having her call reach the local carrier's switch. The call must then be switched by the local carrier and transported to the IXC's point of presence. These steps are necessary for the customer to have access to interexchange services, and therefore fall within the definition of supported services.

**C. Neither The ILEC Oppositions Nor The Commission In The *Order* Explained Why The Commission Can Flout The Fifth Circuit's Prior Decisions And Fail To Make Implicit Support Explicit.**

As set forth above, the ILEC Oppositions fail to dispute that toll averaging and rate integration provides an implicit subsidy for high rate-of-return LEC access costs, and that access is a service supported by federal universal service support mechanisms. In addition, the ILECs, like the Commission in the *MAG Order*, fail to address the express statutory language of Section 254(e), and the Fifth Circuit's previous three decisions holding that all support "must be explicit."

In the *MAG Order*, the Commission professed to be "unclear" as to whether Section 254(e)'s requirement that support be explicit extends to costs that must be averaged under Section 254(g).<sup>10</sup> With respect to services within the definition of supported services, however, the Fifth Circuit could not speak more clearly: the Commission "cannot maintain any implicit subsidies."<sup>11</sup> No party opposing the RCC Coalition's petition explains how the Commission could maintain the *status quo* without flouting the Fifth Circuit's express command. Accordingly, Section 254(e) alone mandates that the Commission grant the RCC Coalition's petition for reconsideration.

**D. The ILECs' Argument That The RCC Coalition Proposes To Set Recovery Below Cost Simply Repeats The Commission's Error With Respect to Traffic Sensitive Access Costs.**

Instead of confronting Section 254(e)'s mandate, the ILEC Oppositions primarily urge that adopting the "Coalition's target rate would . . . be inconsistent with principles of cost-based

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<sup>10</sup> *MAG Order*, ¶89.

<sup>11</sup> *COMSAT*, 250 F.3d at 939.

pricing and present the danger of distorting competition.”<sup>12</sup> This argument, however, is non-responsive and merely repeats the logical error made by the Commission in the *MAG Order*.

As the RCC Coalition pointed out,<sup>13</sup> the Commission’s argument that, when supported by an explicit subsidy, the price of access to the IXC would be “inadequately supported by cost data,” and inconsistent “with the principle of cost-based access pricing”<sup>14</sup> – which the ILECs simply repeat – is unconvincing. All subsidies necessarily reduce price below cost. In this very proceeding the Commission provided an explicit subsidy to replace implicit subsidies that reduced common line prices *below* cost.<sup>15</sup> It therefore is arbitrary to reject an explicit subsidy to reduce traffic sensitive access prices below cost on the ground that the resulting price charged to carrier purchasers would not be “cost based” when the same is true for all other universal service subsidies.<sup>16</sup>

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<sup>12</sup> NRTA et al. Opposition at 10; *see also* Innovative Opposition at 3 (arguing that the Coalition’s “access rate target is much lower than the actual traffic-sensitive costs of many-rate of return carriers”); NTCA Opposition at 2 (“AT&T and others have failed to demonstrate a sufficient correlation between the costs of . . . rate-of-return (ROR) carriers” and the RCC Coalition’s proposed rate.).

<sup>13</sup> RCC Coalition Petition at 15.

<sup>14</sup> *MAG Order*, ¶¶ 83, 88.

<sup>15</sup> RCC Coalition Petition at 16.

<sup>16</sup> The ILECs also err in asserting that the RCC Coalition’s proposed target access price of \$.0095/minute is based solely on the *CALLS Order*. In fact, Exhibits C (1)-(3) to the RCC Petition show that the difference in the average per minute access charges faced by carriers serving low cost areas and carriers serving high cost areas remains substantial unless the price in the high cost areas is brought below \$.0095/minute. The FCC failed even to mention this analysis in rejecting the RCC Coalition’s proposed target price.

In opposing the RCC Coalition’s proposed target rates for the subsidized access price, the ILEC Oppositions (and the Commission) appear to confuse total cost recovery with subsidized price. Total recovery is the combined revenue from all access charges, plus any explicit subsidy. The RCC Coalition has never proposed to reduce *total recovery* below cost, but simply to replace the implicit subsidy for high access costs provided today through toll averaging with an explicit “direct subsidy from support funds.” *Alenco*, 201 F.3d at 623.

**E. Neither The ILEC Oppositions Nor The States (Nor The Commission) Show How Rate Averaging And Integration Without Explicit Support For High Traffic Sensitive Access Costs Benefit Consumers.**

No one – not the Commission in the *MAG Order*, the ILECs, or the State commenters – ever shows or even discusses how consumers – as opposed to incumbent LECs – are better off with a system of implicit subsidies for high rural rate-of-return LEC access costs, rather than a system of explicit subsidies as contemplated by the Act. No party disputes that Exhibit C to the RCC Petition demonstrates that carriers serving high cost rate-of-return LEC areas face a competitive disadvantage when competing against carriers that serve only low access cost areas. Nor does any party dispute that Exhibit C helps to explain the observable reality in the interexchange marketplace that fewer interexchange carriers serve high cost rural rate-of-return LEC service areas than serve the price cap LEC service areas. Rate averaging and rate integration combine with high rural rate-of-return LEC access charges to erect a formidable disincentive to any interexchange carrier expanding out of the low cost service area to offer service in the rural rate-of-return LEC's territory. These undisputed economics harm rural consumers – and create marketplace pressure on those interexchange carriers that do serve rural rate-of-return LEC service areas to find ways geographically to deaverage toll rates.<sup>17</sup>

Several parties argue that the Commission can ignore these economics because rate averaging and rate integration are “the law of the land.”<sup>18</sup> Just because Section 254(g) is the law of the land does not, however, mean that it is sustainable or that, in the absence of explicit support, it does not deter additional IXC entry into rural areas.

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<sup>17</sup> See Rural Task Force Recommendation to the Federal-State Joint Board on Universal Service, CC Docket No. 96-45 (filed Sept. 29, 2000), at 30.

<sup>18</sup> See, e.g., NRTA et al. Opposition at 11; Alaska Comments at 5; Hawaii Comments at 4.

These commenters also suggest that while “the access costs nationwide carriers incur may be higher than those incurred by some regional carriers” there are “offsetting benefits that accrue to the nationwide carriers.”<sup>19</sup> However, these commenters to recognize that the RBOCs, companies with substantial scale, are entering long distance in low cost areas such that any scale economies will not offset the competitive disadvantage of serving high access charge areas.<sup>20</sup>

### **III. THE *ORDER*’S REALLOCATION OF THE TIC TO LOCAL SWITCHING SHOULD BE RECONSIDERED.**

In its Petition, the RCC Coalition argued that there was no basis in the record to support the Commission’s decision to shift recovery of any TIC costs to local switching.<sup>21</sup> No ILEC other than Innovative actually supports the Commission’s decision to allocate some TIC costs to local switching.<sup>22</sup>

As addressed more fully in the RCC Coalition’s Opposition to Petitions for Reconsideration,<sup>23</sup> Plains and other ILECs ignore the fact that the *1997 Access Reform Order* already directed rate-of-return ILECs to reallocate service-specific costs from the TIC to service-specific elements.<sup>24</sup> What remains are residual costs that the Commission and carriers have been unable to assign to specific elements, but may have some relationship to differences in

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<sup>19</sup> See Alaska Comments at 7; Hawaii Comments at 5.

<sup>20</sup> In addition, these commenters ignore the entry-deterring impact of implicit subsidies for high access costs through toll averaging, which deprives rural consumers of additional choices, as well as the impact on regional carriers serving mainly high access cost areas, who face a substantial margin squeeze imposed by regulation. See RCC Coalition Petition at 4-11.

<sup>21</sup> RCC Coalition Petition at 16 (quoting *MAG Order* ¶ 99).

<sup>22</sup> Plains Opposition at 8 (acknowledging that the RCC Coalition is correct “that there is no evidence to support assignment of TIC cost recovery to local switching”); NTCA Opposition at 4-6; NRTA et al. Opposition at 11-12; *but see* Innovative Opposition at 4.

<sup>23</sup> See RCC Coalition Opposition at 19-24.

<sup>24</sup> *Access Charge Reform*, First Report and Order, 12 FCC Rcd. 15982, 16076 (1997) (“*1997 Access Reform Order*”).

the assignment of costs through separations to private line and switched services, and the fact that the cost of providing transport services in rural areas is higher than that reflected by transport rates derived from special access.<sup>25</sup>

It is precisely with respect to these residual costs that the Commission observed in 1997 that “[i]n the absence of definitive evidence as to the nature of the residual TIC amounts,” the “public interest would be better served by imposing these costs . . . on a flat per-line basis, rather than on a per-minute basis.”<sup>26</sup> And although the 1997 *Access Reform Order* transferred these costs to the PICC, those PICC charges were then rolled into the SLC under the *CALLS Order*, maintaining non-traffic sensitive recovery.

Accordingly, as set forth in the Coalition’s Petition,<sup>27</sup> the Commission’s decision in the *MAG Order* to allocate some TIC costs to local switching was inconsistent with the 1997 *Access Reform Order* in two respects: (i) the 1997 *Order* held that it was appropriate to err on the side of non-traffic sensitive recovery; and (ii) the limited evidence of the nature of underlying costs – which has not been supplemented – pointed only to reallocating TIC costs to transport and common line rates but not to local switching rates.

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<sup>25</sup> *Id.* at 16079.

<sup>26</sup> *Id.* at 16084.

<sup>27</sup> RCC Coalition Petition at 23-24 (discussing the *CALLS Order*’s finding that shifting to the information surcharge to common line was “consistent with the Commission’s policy that non-traffic-sensitive costs be recovered by a non-traffic sensitive charge,” *Access Charge Reform*, Sixth Report and Order, 15 FCC Rcd. 12962, 13028 (2000) (“*CALLS Order*”); and the 1997 *Access Charge Order*’s holding that “recovering [marketing] expenses from end users instead of from IXCs is consistent with principles of cost causation,” 12 FCC Rcd. at 16121).

#### **IV. THE COMMISSION SHOULD MOVE THE RECOVERY OF THE INFORMATION SURCHARGE AND MARKETING COSTS TO THE COMMON LINE.**

In opposing the RCC Coalition's requests for reconsideration of the Commission's treatment of the information surcharge and marketing costs, NTCA does not dispute the RCC Coalition's fundamental points. With respect to the information surcharge, the Commission held in the *CALLS Order* that "elimination of the information surcharge is consistent with the Commission's policy that non-traffic-sensitive costs be recovered by a non-traffic sensitive charge,"<sup>28</sup> yet in the *MAG Order* the Commission retained traffic sensitive recovery of these non-traffic sensitive costs. NTCA does not dispute the Commission's inconsistency, its failure to provide a rational explanation as required under the Administrative Procedures Act, or even the Commission's previous finding that these costs are non-traffic sensitive. Accordingly, the *MAG Order* remains arbitrary and capricious with respect to its handling of the information surcharge.

Likewise, NTCA does not defend the Commission's erroneous reading of its own accounting rules that underlay its justification for failing to recover marketing costs through common line elements. NTCA instead simply asserts that recovering such costs through common line elements and the ICLS would create an implicit subsidy. This is nonsense. The ICLS is an explicit subsidy, not an implicit subsidy, and marketing is one of the costs of providing universal service.

#### **V. CONCLUSION**

For the reasons set forth in the RCC Coalition's petition for reconsideration, as well as the reasons stated above, the Coalition's petition should be granted.

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<sup>28</sup> *CALLS Order*, 15 FCC Rcd. at 13028.

Respectfully submitted,



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## CERTIFICATE OF SERVICE

I, Timothy Simeone, hereby certify that a copy of the foregoing Rural Consumer Choice Coalition Reply to Oppositions to Its Petition for Reconsideration was served on this 25<sup>th</sup> day of February, 2002 via first-class mail, postage prepaid on all parties listed below:

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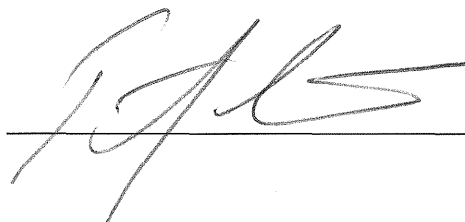
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